

Office of the State Auditor

Division of State Audit

Secretary of State
Bismarck, North Dakota

Audit Report for the
Two-Year Period Ended June 30, 2006
Client Code 108

Robert R. Peterson
State Auditor



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Transmittal Letter

May 7, 2007

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
The Honorable Al Jaeger, Secretary of State

We are pleased to submit this audit of the Secretary of State for the two-year period ended June 30, 2006. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Kevin Scherbenske, CPA. Kristi Morlock and Jamie Abraham were the staff auditors. Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2320. We wish to express our appreciation to Mr. Jaeger and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

INTRODUCTION

The North Dakota Secretary of State is to record and preserve all the laws and proceedings of the legislative assembly, the acts and proceedings of the Governor, and is also charged with the custody of the enrolled copy of the Constitution of North Dakota, the Great Seal, and all items deposited in the office pursuant to law.

The Secretary of State is the State Athletic (Boxing) Commissioner and the state's Chief Election Officer.

The Secretary of State is also responsible for Uniform Commercial Code filings, contractor licensing, and recording trademarks/trade names.

There are four major divisions within the Secretary of State's office: Administrative/Licensing Division; Business Information/Registration Division; Central Indexing Division; and the Elections Division. Additional information can be found at their website: <http://www.nd.gov/sos/>

RESPONSES TO LAFRC AUDIT QUESTIONS

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Secretary of State in accordance with generally accepted accounting standards so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Yes.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. *Has action been taken on findings and recommendations included in prior audit reports?*

The Secretary of State has implemented all recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 18 of this report, along with management's response.

LAFRC AUDIT COMMUNICATIONS

1. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

2. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Secretary of State's financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

5. *Identify any serious difficulties encountered in performing the audit.*

None.

6. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

7. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance, Human Resource Management System (HRMS), and the AS400 (Secretary of State's accounting system) are high-risk information technology systems critical to the Secretary of State.

Background Information

The mission of the North Dakota Secretary of State is to serve the citizens of the state of North Dakota and its guests; execute with integrity the duties required by the North Dakota Constitution and the North Dakota Century Code; collect and preserve the records of the state as defined by the law; and act as an ambassador for the state of North Dakota, its people, and its way of life.

The North Dakota Secretary of State is Al Jaeger, who is elected by the citizens of North Dakota.

The Administrative/Licensing Division of the office handles a number of diverse duties. These duties range from working with the legislature to the licensing and regulation of boxing. Nearly all of the revenue from this division comes from the issuance of contractor and charitable solicitation licenses, registration of lobbyists, and the commissioning of notaries.

Secretary of State includes:

- Administrative/Licensing.
- Business Information/Registration.
- Central Indexing.
- Elections.
- State Athletic Director.

The Business Information/Registration Division of the office is responsible for the recording and filing of trade names/trademarks, articles of incorporation, annual reports, and other required legal documents for corporations both domestic and foreign, nonprofit corporations, limited liability companies and partnerships. Revenue from this division is generated from a variety of fees charged for filings, amendments, reports, lists, and registrations.

The Central Indexing Division of the office is responsible to process and file Uniform Commercial Code (UCC) filings and other types of lien documents. These documents are filed to protect the collateral of secured parties. The revenue created by this division comes through the performance of these duties.

The Elections Division administers election law. The general mandate of election law is to maintain the integrity of the election process and to always protect the rights of the people, as provided for in the constitution and laws of the state of North Dakota. The revenues generated by this division are primarily derived from filing fees assessed for reports, registrations, and for copies of public records.

The Secretary of State also serves as the state athletic director, overseeing boxing matches held within the state of North Dakota.

The North Dakota Secretary of State's budget for the 2005-2007 biennium totals \$14.5 million. This represents a 2.5% increase over the 2003-2005 budget. The state general funds comprise \$4.6 million of the 2005-2007 budget.

More information about the agency can be obtained from the Secretary of State's home page at:

<http://www.nd.gov/sos/>

Audit Objectives, Scope, And Methodology

Audit Objectives

The objectives of this audit of the Secretary of State for the two-year period ended June 30, 2006 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the most important areas of the Secretary of State's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Secretary of State and are they in compliance with these laws?
3. Are there areas of the Secretary of State's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Secretary of State for the two-year period ended June 30, 2006 was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. To meet the objectives outlined above, we:

Audit Methodology

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and reviewed management's discussion and analysis of the financial statements.
- Performed detailed analytical procedures for expenditures and receipts.
- Tested samples of expenditures, journal vouchers, and correcting entries.
- Reviewed prior year audit workpapers.
- Interviewed appropriate agency personnel.
- Reviewed Secretary of State written plans and applicable manuals.
- Reviewed Secretary of State's biennial report.
- Observed Secretary of State's processes and procedures.
- Reviewed North Dakota Century Code chapter 54-09 and 2003 and 2005 Session Laws.

Management's Discussion And Analysis

The accompanying financial statements have been prepared to present the Secretary of State's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

The following management discussion and analysis was prepared by Secretary of State's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of this supplementary information to ensure it does not conflict with the knowledge we gained as part of our audit.

For the two-year period June 30, 2006, operations of the Secretary of State were primarily supported by appropriations from the state's general fund. Additional revenue was received from the federal government related to elections and fees credited to the agency's general services operating fund.

FINANCIAL SUMMARY

For the state's general fund, the agency produces revenue related to its responsibilities associated with licensing, registrations and annual reporting, and filing of various lien documents. The agency issues licenses to contractors, registers charitable organizations and lobbyists, and commissions notaries public. Using a statewide central database connected to the state's County Records, documents are filed, and information sold by subscription, associated with the Uniform Commercial Code (UCC), agricultural products and livestock, and miscellaneous liens. The agency processes documents pertaining to over 40 business related categories including trademarks, trade names, investment trusts, corporations, various partnerships, and limited liability companies. Other revenue for the general fund was received from the sale of public information filed with the agency. The revenue for the general fund was approximately 10% higher on June 30, 2006, compared to the same date in 2005.

As allowed by the provisions of N.D.C.C. § 54-09-08, the revenue received for the sale of public information related to businesses is placed in a special fund titled the General Services Operating Fund. It allows the agency to retain revenue for covering the expenses for providing the information in direct response to the demand for it, which is difficult to predict. The revenue for the special fund for the year ending June 30, 2006 was approximately 10% higher than the previous year.

The combined revenue generated in the 2003/2005 biennium for the general and the special funds exceeded expenditures by approximately 2.5 million dollars.

Under the provisions of the Help America Vote Act of 2002 (HAVA), the state received three funding installments. The second and third installments of \$4,150,000 and \$7,446,803 respectively appear as revenue for the period of June 30, 2005. Congress has not yet appropriated the FY 2005 funds due to the states under the HAVA legislation. North Dakota's share of the yet to be appropriated funds is \$3,403,197. The revenue for the period ending June 30, 2006, were reimbursements from United States Department of Health and Human Services related to polling place accessibility.

The "grant to counties" amounts for the years ending 2005 and 2006 represents the transfer of equipment for the new statewide voting system to the counties. Approximately one-half of the counties received a portion of the equipment in the year ending 2005 with the balance of the equipment distributed to all of the counties during the year ending 2006, which is reflected in the higher grant amount.

AGENCY INITIATIVES

To provide timely services to the public, the effective use of technology is important for the agency's productivity and the fair administration of state laws, which are clear in their processes and purposes. Therefore, by building on significant advances reported during previous audit periods, the agency continues to place a priority on developing and improving services for its customers, taxpayers, and citizens through a variety of ways.

Through the legislative process, the agency supports and promotes the passage of legislation that clarifies, updates, or repeals obsolete sections of state law as they related to each of the agency's administrative functions.

A significant accomplishment was the successful implementation of the provisions of the Help America Vote Act of 2002 (HAVA). By collaborating with the North Dakota Association of Counties, the state achieved a positive working relationship unlike any in the country. It resulted in elections held without incident.

The agency's web-based Election Management System (EMS), utilized for the first time in the June 2004 statewide election, has been improved. In addition, the agency has in development an Election Administration System to be used in conjunction with the new statewide voting system. Both applications provide more voter and candidate information, timely election results, campaign

finance reports, and county poll books, among other features to support the election process.

In an effort to improve its services, productivity, efficiency, and provide electronic on-line filing of registrations and reports, the agency is acquiring and implementing a new software application to replace existing technology systems for Central Indexing System (CIS) filings, and business, licensing, and administrative services. It is titled Secretary of State Knowledge Base (SOSKB). The phasing out of the state's mainframe computer also requires this change.

In the previous audit, reference was made to the New Business Registration website, which is a cooperative effort on the part of several state agencies. Through the support of several members of the State Information Technology Advisory Committee (SITAC), a study was completed for implementing a Business Development Engine, which is an enterprise level project and which will include several of the observations made in the last audit. The legislature approved the project subject to the availability of funding.

Financial Statements

STATEMENT OF REVENUES AND EXPENDITURES

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
<u>Revenues and Other Sources:</u>		
Licenses, Permits, and Fees	\$3,344,940	\$3,037,708
Interest Earnings	336,030	47,368
Revenue from Federal Government	250,038	11,596,803
Sale of Information	236,782	215,350
Miscellaneous Refunds	169,320	
Revenue from Counties		58,441
Total Revenues and Other Sources	<u><u>\$4,337,110</u></u>	<u><u>\$14,955,670</u></u>
<u>Expenditures and Other Uses:</u>		
Grants to Counties	\$3,581,418	\$1,927,243
Salaries and Benefits	1,136,287	1,076,164
IT–Data Processing/Services/Equipment	729,095	782,080
Election System Coordination	495,881	233,705
Books	180,336	41,655
Postage	66,528	79,945
Printing	61,766	53,647
Travel	30,073	26,895
Office Supplies	19,580	19,014
Miscellaneous Expenses	40,765	46,034
Total Expenditures and Other Uses	<u><u>\$6,341,729</u></u>	<u><u>\$4,286,382</u></u>

STATEMENT OF APPROPRIATIONS

For The Year Ended June 30, 2006

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 2,302,602		\$ 2,302,602	\$ 1,136,287	\$ 1,166,315
Operating Expenses	2,528,061		2,528,061	1,016,553	1,511,509
Capital Assets	15,000		15,000		15,000
Petition Review	8,000		8,000		8,000
Election Reform	9,579,728	\$ 105,000	9,684,728	4,184,165	5,500,562
Totals	<u>\$ 14,433,391</u>	<u>\$ 105,000</u>	<u>\$ 14,538,391</u>	<u>\$ 6,337,005</u>	<u>\$ 8,201,386</u>
Expenditures by Source:					
General Fund	\$ 4,489,363	\$ 105,000	\$ 4,594,363	\$ 2,210,690	\$ 2,383,673
Other Funds	9,944,028		9,944,028	4,126,315	5,817,713
Totals	<u>\$ 14,433,391</u>	<u>\$ 105,000</u>	<u>\$ 14,538,391</u>	<u>\$ 6,337,005</u>	<u>\$ 8,201,386</u>

Appropriation Adjustments:

The \$105,000 increase in the election reform line is a result of an emergency measure pursuant to House Bill 1002, section 5 of the 2005 Legislature. An amount up to \$105,000 was authorized to be used as state match funds. The funds were used for the purchase of new voting equipment.

Expenditures Without Appropriations Of Specific Amounts:

The Athletic Advisory Board Fund has a continuing appropriation authorized by NDCC section 53-01-09 (\$4,602 of expenditures for this fiscal year).

For The Biennium Ended June 30, 2005

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 2,153,618		\$ 2,153,618	\$ 2,121,564	\$ 32,054
Operating Expenses	2,361,589	\$ 44,637	2,406,226	2,338,999	67,227
Petition Review	8,000		8,000	3,821	4,179
Election Reform	9,500,000	78,364	9,578,364	4,278,704	5,299,660
Totals	<u>\$ 14,023,207</u>	<u>\$ 123,001</u>	<u>\$ 14,146,208</u>	<u>\$ 8,743,088</u>	<u>\$ 5,403,120</u>
Expenditures by Source:					
General Fund	\$ 4,142,844	\$ 105,000	\$ 4,247,844	\$ 4,122,081	\$ 125,763
Other Funds	9,880,363	18,001	9,898,364	4,621,007	5,277,357
Totals	<u>\$ 14,023,207</u>	<u>\$ 123,001</u>	<u>\$ 14,146,208</u>	<u>\$ 8,743,088</u>	<u>\$ 5,403,120</u>

Appropriation Adjustments:

The \$78,364 increase in the election reform line is a result of an emergency measure pursuant to Senate Bill 2002, section 2 of the 2003 Legislature. An amount up to \$105,000 was authorized to be used as state match funds from the general fund of which, \$26,636 was already spent. The election reform line was increased for the remaining \$78,364.

The \$44,637 increase in the operating line was for an increase in spending authority for the General Services Operating Fund due to greater than anticipated revenue. This was approved by the Emergency Commission.

Expenditures Without Appropriations Of Specific Amounts:

The Athletic Advisory Board Fund has a continuing appropriation authorized by NDCC section 53-01-09 (\$7,720 of expenditures for this biennium).

Internal Control

In our audit for the two-year period ended June 30, 2006, we identified the following areas of the Secretary of State's internal control as being the most important:

Internal Controls Subjected To Testing

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the computer-based Business Registration System.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered significant. We concluded internal control was adequate. Our consideration of internal control would not necessarily disclose all matters that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements that would be material may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control and its operation that we consider to be material weaknesses. However, we noted other matters involving internal control that we have reported to management of Secretary of State in a management letter dated May 7, 2006.

Compliance With Legislative Intent

In our audit for the two-year period ended June 30, 2006, we identified and tested Secretary of State's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

Legislative Intent Subjected To Testing

- Establishment of rules for electronic signatures (NDCC section 1-08-12).
- Revocation of Contractor Licenses within 20 days of failure to correct any noted deficiencies (NDCC section 43-07-04).
- Notary Public renewal notice procedures (NDCC section 44-06-02).
- Sale of Session Laws to provide for maximum recovery of costs with a minimum number destroyed (NDCC section 46-04-18).
- Fees to pay for expenses of members of the athletic advisory board for applicable athletic events do not exceed 1% of gross revenue of the exhibition (NDCC section 53-01-07).
- Establishment of Voting Standards – voting precincts, polling locations, maps, pollbooks, and forms (NDCC section 16.1-01-01).
- Rules for certification of voting systems and machines (NDCC section 16.1-06-26).
- Central Voter file establishment and funding limited to state election funds (NDCC section 16.1-02-02 and 16.1-02-03).
- The use of the following legally restricted funds:
 - ✓ Election fund.
 - ✓ Athletic Commission fund.
- Application of proper statutory rates relating to revenue.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2005 North Dakota Session Laws chapter 2 and 2003 North Dakota Session Laws chapter 23).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.
- Submission of biennial report (NDCC section 54-09-04).

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified on the previous page.

Operations

This audit did not identify areas of Secretary of State's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Management Letter (Informal Recommendations)

May 7, 2007

The Honorable Al Jaeger
Secretary of State
North Dakota Secretary of State
600 E. Boulevard Avenue
Bismarck, North Dakota 58505

Dear Mr. Jaeger:

We have performed an audit of the Secretary of State for the two year period ended June 30, 2006, and have issued a report thereon. As part of our audit, we gained an understanding of the Secretary of State's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted a certain condition we did not consider reportable within the context of your audit report. This condition relates to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendation to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if this recommendation has been implemented, and if not, we will reconsider its status as a non-reportable condition.

The following presents our informal recommendation.

GENERAL LEDGER

Informal Recommendation 06-1: We recommend all correcting entries in the General Ledger have adequate support and be approved by the appropriate level of management.

Management of Secretary of State agreed with this recommendation.

I encourage you to call myself or an audit manager at 328-2243 if you have any questions about the implementation of the recommendation included in this letter.

Sincerely,

Kevin Scherbenske
Auditor in-charge